Cour des comptes

PUBLIC FINANCES AND ACCOUNTS

THE SITUATION AND OUTLOOK OF PUBLIC FINANCES

Summary

June 2019

DISCLAIMER

This summary is intended to help understanding and using the report prepared by the Cour des comptes.

Only the report is legally binding on the Cour des comptes.

The responses of the Ministry for the Economy and Finance and the Ministry of Public Action and Accounts appear after the report.

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Introduction

This report on the situation and outlook of public finances is conducted, like every year, pursuant to Article 58, paragraph 3 of the by-law relating to finance acts.

Submitted along with the Government report on the evolution of national economy and public finance guidelines, this report is geared towards fuelling the debate that the Parliament holds every year in July on public finance guidelines for the next years (Article 48 of the by-law relating to finance acts).

In this report, the Cour first studies the situation of public finances in 2018 and how this situation has evolved compared with previous years, as well as the situation of each of the main categories of general government: the State, social security funds and local government. It examines how France positions in relation to other European countries in 2018.

The Cour then analyses the information available on the 2019 fiscal year prior to 18 June and presents the risks surrounding the achievement of revenue, expenditure and balance forecasts in the April 2019 Stability programme for all of general government.

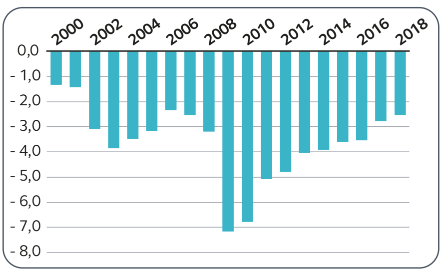
Lastly, the Cour determines which risks weigh on the public finance trajectory set out in the stability programme for 2019 to 2022 and their consequences on the sustainability of the public finance trajectory.

1 2018: a moderate reduction in deficit, a barely stabilised public debt, a worse situation than in most countries of the Euro area

A slightly reduced public deficit in 2018

In 2018, public deficit reached 2.5 GDP points. It has once again reduced, albeit less than in 2017 (- 0.3 points compared with - 0.8 points in 2017).

General government balance (in GDP points)



Source: Insee

Structural deficit only reduced by 0.1 GDP points according to the Government and is still - at 2.3 GDP points - much higher than the medium-term objective (a structural balance above -0.4 GDP points) that France has set itself since the public finance programming act for 2014-2019. With a structural adjustment of 0.1 GDP points in 2018, France could meet its European commitments but will have used up this year alone the entire margin of flexibility afforded to it by texts over two years: given its public finance results and its position in the economic cycle, European rules require France to reduce its structural deficit by more than 0.5 GDP points (i.e. at least 0.6 GDP points according to the interpretation of the Commission and the Council), but allow for a 0.5 GDP point deviation over one year or cumulated over two years.

Expenditure efforts were limited to 0.3 GDP points. Given the measures to decrease mandatory levies decided for 2018 (-0.2 GDP points), this only enabled a moderate reduction of structural deficit, despite spontaneous growth in the return provided by mandatory levies which was once more greater than the GDP.

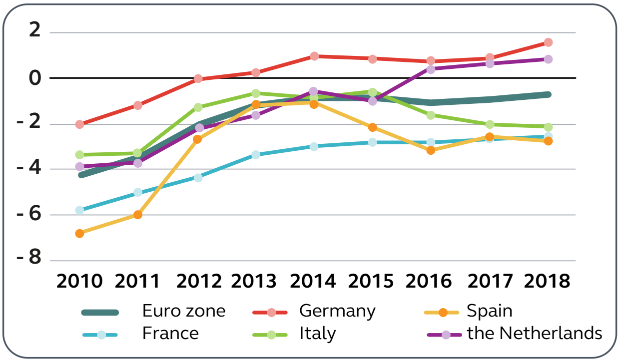
2018: a moderate reduction in deficit, a barely stabilised public debt, a worse situation than in most countries of the Euro area

A growing gap with our partners

In 2018, according to the European Commission's estimates, France's structural deficit is much higher than that of the Euro zone as a whole (0.7 GDP point).

Whereas in 2010, France's structural deficit was higher than the structural deficit in the Euro zone as a whole (5.8 GDP points compared with 4.3), according to European Commission estimates, the cumulative structural effort for the 2011-2018 period was slightly less in France than in the Euro zone (3.5 points compared with 4). In addition, in France, these efforts mainly concerned revenue, whereas in the Euro zone efforts were more balanced between expenditure and revenue.

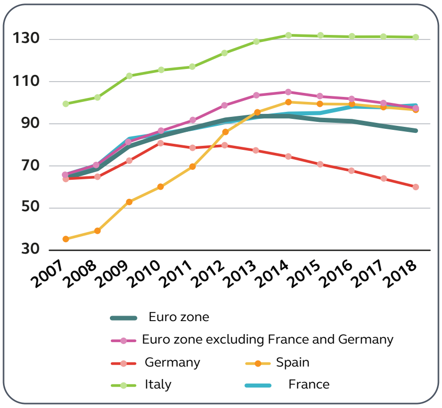
Structural balance in the European Union countries



Source: Cour des comptes according to data from the European Commission (AMECO macroeconomic database), May 2019 forecasts

While the public debt-to-GDP ratio (98.4 GDP points in 2018, as in 2017) has stopped rising, for the first time in over ten years, the difference in debt trajectory between France and its main partners has continued to increase: German public debt has continued its rapid decline, barely exceeding 60 GDP points in 2018, and that of the Euro zone excluding Germany and France has been declining since 2014 and is now below that of France.

Public debt (in GDP points)



Source: Cour des comptes according to data from Eurostat

2 In 2019, a projected increase in headline deficit, worrying structural balance and public debt evolutions

In 2019, Government foresees a public deficit of 3.1 GDP points which should therefore once more be above the 3-point threshold. However, the increase in deficit is a result of the conversion of competitiveness and employment tax credit (CICE) into a permanent reduction in social contributions, which temporarily deteriorates the balance by 0.9 GDP points. Without this impact, the deficit would be reduced by 0.3 GDP points according to the Government's forecast.

In 2019, a projected increase of headline deficit

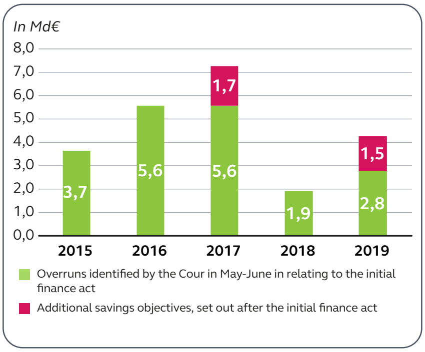
For 2019, the stability programme foresees an annual GDP growth of 1.4%, a 3.1% growth in the private sector wage bill and 1.3% growth in consumer prices. However, the evolutions at the beginning of the year, which were slightly less favourable than planned in terms of growth and, especially, in terms of wage bill and inflation, lead to uncertainties as regards these macroeconomic forecasts and therefore as regards the expected level of mandatory levies.

Furthermore, the expenditure forecast is affected by a moderate risk of overrun, concerning unemployment benefits, local authority investments and the State's controllable expenditure in particular.

The analysis performed by the Cour, on a mission-by-mission basis, highlights a risk of overrunning in the field of "controllable expenditure growth norms" of the state by €2.8bn in relation to the initial finance act as a central assumption, i.e. a higher risk than that identified last year at the same time. Above all, in order to finance part of the measures announced at the end of 2018, the Government has reduced its controllable expenditure objective by €1.5bn in the April 2019 stability programme forecast, but has not specified which expenditures and missions this reduction is to affect. For this new target, the risk of overrunning therefore amounts to €4.3bn in total. At this stage, meeting the objectives relating to the State's controllable expenditure is not a certainty.

In 2019, a projected increase in headline deficit, worrying structural balance and public debt evolutions

Risks of overrun identified by the Cour during the previous fiscal years and in 2019



Source: Cour des comptes according to data from the Cour des comptes' previous reports

However, the low level of interest rates should lighten the debt burden which, in combination with possible savings relating to the period required to build up France compétences - created in 2019 to regulate and finance vocational training and apprenticeships -, allows for the achievement of central government's total expenditure objective (State and various central government bodies).

In sum, the public deficit forecast for 2019 is plausible but is affected by a moderate risk of overrun.

Worrying structural balance and public debt evolutions

In 2019, the expected evolution of public finances includes two worrying evolutions.

Structural adjustment would be limited to 0.1 GDP point in 2019, like in 2018. Over both years, the average structural adjustment would therefore be 0.5 point below that required by European rules, i.e. a gap that is 0.25-point higher than the margin authorised by such rules over two years. France would therefore not be in compliance with its European commitments.

Structural deficit, once again higher than 2 GDP points in 2019, would still be far from the medium-term objective.

After stabilising in 2018, the public debt-to-GDP ratio is expected to increase once more, in contrast to the evolution experienced by most of our partners in the Euro zone. Although this evolution is partly attributable to the temporary impact of the conversion of competitiveness and employment tax credit (CICE) into a reduction in social contributions, it also more importantly translates the slow progress made by France to reduce its structural deficit.

3 2019-2022: a less ambitious trajectory for recovery, an achievement affected by many risks

In its April 2019 stability programme, the Government forsees an improvement in headline and structural balances, of 1.9 and 0.8 GDP points respectively, between 2019 and 2022. Over the same period, public debt would decrease by 2 GDP points. The chosen trajectory, which has more limited ambition, is also weakened by the announcements made following the great national debate and there are high risks of this trajectory not being followed.

By 2022, a significantly slower recovery of public finances compared to the previous stability programme

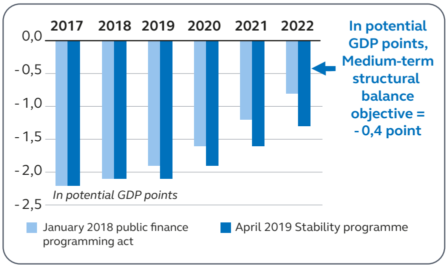
The trajectory set out by the April 2019 stability programme is less demanding than the trajectories set out in the public finance programming act of January 2018 and in the April 2018 stability programme. As regards the latter, the public deficit forecast would increase by 1.3 GDP point by 2022, with that of structural deficit increasing by 0.8 point and that of debt by 5.4 points. This revision means another postponement - far beyond 2022 - of the date forecast for structural deficit to return to the medium-term objective and a much smaller reduction in the public debt-to-GDP ratio than anticipated.

This revision is partly a result of the adoption of more realistic growth assumptions, which was necessary due to the significant deterioration of the economic situation over the last year.

However, it is also a product of additional measures to significantly reduce mandatory levies and of reduced ambition as regards primary expenditure control (excluding interest expenditure), which are partly compensated for by a reduction in expected interest expenditure.

2019-2022: a less ambitious trajectory for recovery, an achievement affected by many risks

History of the structural balance in the public finance programming act and in the stability programme



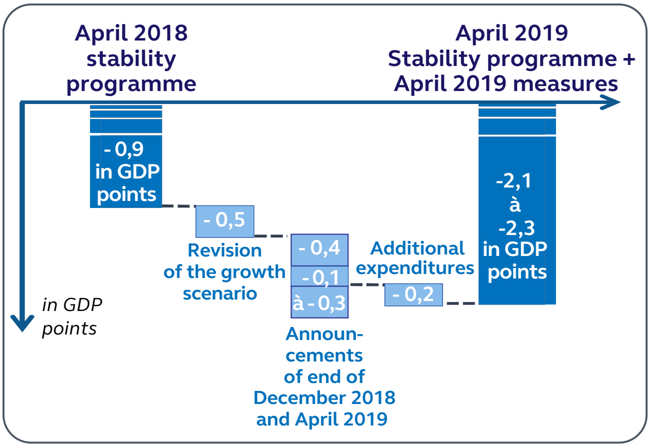
Source: Cour des comptes based on data from the cited documents

The April 2019 stability programme is no longer consistent with the public finance programming act: the gap between the structural deficit forecast in the stability programme and that in the programming act is expected to be "significant" within the meaning of the by-law of 17 December 2012. This should therefore lead the High Council of Public Finances to trigger the correction mechanism, according to which the Government must take this gap into account at the latest in the next finance act of the year or in the social security finance act of the year, as foreseen in the by-law.

Decisions announced following the great debate that weaken the prospect of recovery

The deficit forecast in the April 2019 stability programme - the only one which, at the end of June 2019, is formalised in a text committing the Government -, which was already revised with a sharp increase in comparison to the previous stability programme, is also weakened, for 2020 and the following years, by the decisions announced following the "great national debate" in April 2019.

Breakdown of the evolution of the general government balance forecast for 2020 since the April 2018 stability programme



Source: Cour des comptes based on stability programmes and the data provided by the Ministry of Finance

The announced return of the indexation of pensions for around 60% of retirees and the raising of the minimum pension increase expenditures by €1.5bn compared with the stability programme forecast. In addition, the announced reduction in income tax reduces revenue by €5bn.

The Government has announced its intention to compensate for these measures by removing tax and social contribution exemptions and making expenditure savings, however, given the magnitude of the measures announced, it seems unlikely that this will be fully compensated for during the 2020 fiscal year. Consideration of these measures could therefore deteriorate the public deficit forecast for 2020 by between 0.1 and 0.3 GDP point, depending on their degree of compensation.

Significant risks over the 2020-2022 period

The stability programme forecast expects, as has often been the case in the past, a significant improvement of the public finance trajectory over the last years (here 2021 and 2022), with a significant decline forecast for headline and structural deficits and a declining debt-to-GDP ratio, based on growing efforts to control public expenditures. Such a prospect is weakened due to the fact that the policies to be carried out to achieve such an adjustment are only rarely documented and that this trajectory contains risk factors.

In terms of its overall consistency, this forecast highlights an increasing difference between the balances of social security funds and local governments, with forecasts of a growing surplus over the entire trajectory, and the central government balance, with a significant deficit that has stabilised around 3 GDP points. This difference partly results from the fact that the State bears most of the decisions to decrease mandatory levies for the entire general government perimeter when it does not have the ability to make expenditure reductions of the same magnitude in its own field.

This difference generates risks as it is likely to reduce incentive to control social security fund and, especially, local general government expenditure. As such, a sharp increase of local governments surplus to levels (0.6 GDP point) not witnessed since the early 1950s appears uncertain. Local governments could indeed use the margins generated by a controlled evolution of their operating expenditures to increase their investments or reduce local taxes.

Should it occur, this increase in the difference in general government balance between the State and the other categories of general government would require a reassessment of the current distribution of revenue and expenditure between the State, social security funds and local governments, as called for by the Cour's report of June 2018.

2019-2022: a less ambitious trajectory for recovery, an achievement affected by many risks

General government balance according to general government category in the April 2019 stability programme (in GDP points)

	2017	2018	2019	2020	2021	2022
General government balance, of which :	**-2.8**	**-2.5**	**-3.1**	**-2.0**	**-1.6**	**-1.2**
-Central general government	-3.1	-3.1	-3.7	-3.0	-3.1	-3.0
-Local general government	0.1	0.1	0.1	0.2	0.5	0.6
-Social security funds	0.2	0.5	0.5	0.8	1.0	1.2

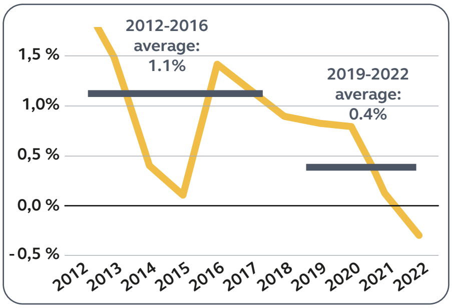
Source: Cour des comptes Cour des comptes based on data from the cited documents; warning: additions do not always provide the exact amount of the corresponding aggregate due to rounding

The trajectory is also affected by many weaknesses.

Thus, the revenue forecast implies a stability of the revenue-to GDP ratio excluding mandatory levies, when these revenues have been steadily declining by 0.1 GDP point per year for 10 years.

Furthermore, the expenditure forecast implies a significant decline in their growth in terms of volume, without the measures for achieving this having been detailed. The public expenditure revision process, set out by the "Action Publique 2022" programme launched at the end of 2017, has clearly lost momentum. The measures announced up until now, and particularly during the Interministerial Public Transformation Committee (Comité interministériel de la transformation publique, CITP) of 29 October 2018, alone, do not seem enough to reach the expenditure target set by the Government in the public finance programming act. Significant risks weigh on several State expenditures (levies on income earmarked for the European Union, transport infrastructure expenditure, investments for the Olympic Games of 2024, expenditures of the Labour and Employment and Solidarity, Integration and Equal Opportunities missions). In addition, the planned increase in the coverage of certain expenditure by health insurance and the uncertainties weighing on the major savings expected from unemployment insurance impact the social security funds' overall expenditure forecast.

Expected growth of public expenditure excluding tax credits and interest expenditure* in the last stability programme, in volume (GDP price)



** Excluding the recapitalisation of Areva and excluding the 3% tax reimbursement.*
Source: Cour des comptes based on data from the April 2019 stability programme

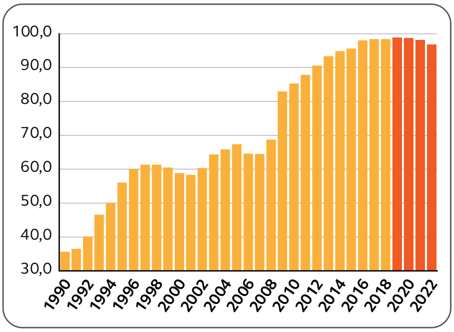
2019-2022: a less ambitious trajectory for recovery, an achievement affected by many risks

Lastly, the growing efforts announced as regards the evolution of expenditure in terms of volume between 2019 and 2022 are not due to a slowing of expenditure in terms of value but rather to an increase in inflation (+1.3% in 2019 to +1.75% in 2022), which is far from certain in a context in which the evolution in prices is still lacklustre in a large number of countries despite high pressure on production capacity. A delay in the expected rise in inflation would therefore pose serious risks for the volume growth objective for expenditures that are the subject of targets in terms of value (State expenditures, national health insurance expenditure objective and local authority operating expenditure in particular).

Reduced room for manoeuvre to deal with an economic slowdown or a financial shock

The public finance trajectory - which is less ambitious than that of several of our partners in the Euro zone – results in further differences in terms of public debt objectives. Public debt is forecast to decline much more in these countries than in France. This increasing gap between France and its partners is worrying and could lead to a deterioration in how investors see the quality of France's signature.

Public debt in GDP points



Red: forecast

Source: Insee and April 2019 Stability programme

Although low interest rates during recent years and their consequences on the resulting interest expenditure have, until now, appeared to numb the increase in public debt, it would be unwise to count on a sustainable maintaining of interest rates at a low level. History teaches us that rises in interest rates can be brutal, especially for a country which, like France, has a public debt significantly higher than that of some of its neighbours.

Under these conditions, the planned sustaining of structural deficit and public debt at a high level in the coming years, especially if the risks noted by the Cour for the expenditure and revenue trajectory materialise, would risk significantly limiting room for manoeuvre to deal with an economic slowdown or financial shock.

Conclusion

France's public finance situation has only slightly improved in 2018, despite a favourable economic context.

Its public finance trajectory continues to set itself apart from those taken by its partners. France is far from having absorbed its structural deficits, when many of its European neighbours have almost reached a balance in 2018. France's debt trajectory is different to that of its main partners, and particularly Germany.

The public finance trajectory set out by the April 2019 stability programme is less demanding than that set out in the previous stability programme(April 2018) or that set out in the public finance programming act of January 2018. The targeted reduction in structural deficit is slow. The expected public debt-to-GDP ratio would only be slightly lower and would still be close to 100 GDP points in 2022. These objectives are also weakened by the measures announced in April 2019 to reduce levies and to increase expenditure announced, which may not be compensated for. Lastly, the policies allowing for a gradual change in the direction of expenditure as required by the trajectory have not been detailed.

Given the high level of both the debt and deficits, the announced continuing decrease in mandatory levies cannot result in a relaxation of objectives to reduce such levies. Such a trend must be accompanied by vital expenditure efforts in order to enable France to keep full control over its budget choices, particularly in the event of an economic slowdown or financial shock.